IN THE HIGH COURT OF BOMBAY AT GOA

INCOME TAX APPEAL NO.32 OF 2002.

The Commissioner of Income Tax,
Having office at Aayakar Bhavan,
Patto, Plaza, Panaji - Goa. ..... Appellant

V/S

1. Mandovi Hotel Pvt. Ltd.,
   D.B. Marg,
   Panaji - Goa.

2. The Income Tax Appellate Tribunal
   Panaji Bench, Aayakar Bhavan,
   Patto Plaza, Panaji - Goa. ..... Respondents

Mr. S. R. Rivankar, advocate for the appellant.

None for the respondents.

CORAM : R. M. LODHA &
N. A. BRITTO, JJ.

DATE : 30th August, 2005.

ORAL JUDGMENT (Per R. M. LODHA, J.)

This Appeal is at the instance of the Revenue and it raises the following substantial question of law :-

> "Whether on the facts and in the circumstances of the case, the amount of Rs.l,34,678/- paid by the Assessee to the retiring partners is in the nature of revenue expenditure or capital expenditure?"

The aforesaid question arises in the facts and circumstances that may be briefly noticed by us :

M/s. Apurva Enterprises was a partnership firm constituted under the instrument of Partnership Deed dated 12th July, 1982. The partnership firm had three partners, namely (i) Narcinva Purxotoma Quenim; (ii) Smt. Crisnabai Vaman Quenim and (iii) Mandovi Hotels Private Limited. The partnership firm came into effect from 1st April, 1982 and was engaged in the business of running hotels. Vide Memorandum of Understanding entered into between the parties on 6th August, 1990, the parties decided that the two partners, namely Narcinva Purxotoma Quenim and Smt. Crisnabai Vaman Quenim would disassociate from the partnership firm and the continuing partner Mandovi Hotels Private Limited would continue the business. The said Memorandum of Understanding incorporated the mutually agreed terms and conditions. Thereafter the Dissolution Deed was executed on 4th September, 1990 between the three partners. The partners mutually decided to dissolve the partnership firm as from lst September, 1990. It was also agreed between the partners that all assets and liabilities of the partnership business shall be taken

over by the Mandovi Hotels Private Limited and the business shall continue to be carried on by the said partner. The Dissolution Deed incorporated the other terms agreed upon between the parties. For the Assessment Year 1994-1995, the respondent no.1-Mandovi Hotels Private Limited (for short "the assessee") filed its return of income declaring total income at Rs.28,945/- after set off of unabsorbed depreciation of Rs.5,58,727/- and deduction under Section 80 HHD of Rs.49,803/- . The return was processed under Section 143(1)(a) of the Income Tax Act, 1961 (for short "the Act") and selected for scrutiny. The notice under Section 143(2) of the Act was issued. The assessee filed its reply. Since the Appeal concerns disallowance of expenditure of Rs.l,34,678/- , suffice it to notice that in the Assessment Order dated 29th March, 1996, the Assessing Officer disallowed an amount of Rs.l,34,678/- being capital in nature and added the said amount to the income of the assessee. The income of Rs.l,34,678/- was the payment that was paid by the assessee to the retiring partners in the relevant previous year. The assessee aggrieved by the Assessment Order disallowing the expenditure of Rs.l,34,678/- as capital in nature, preferred appeal before the Commissioner of Income Tax (Appeals).

By his Order dated 24th April, 1998, the Commissioner of Income Tax (Appeals) dismissed the appeal preferred by the assessee and maintained the order of the Assessing Officer disallowing the expenditure of Rs.l,34,678/- being capital in nature. Aggrieved by the concurrent orders passed by the Assessing Officer and the Appellate Authority, the assessee preferred appeal before the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal allowed the appeal and held that the amount of Rs. l,34,678/- was allowable as expenditure in revenue and not capital in nature. Upset by the judgment of the Income Tax Appellate Tribunal passed on 31st October, 2001, the revenue has preferred this appeal.

2. As already noticed by us, initially by the Memorandum of Understanding dated 6th August, 1990, the partners of the firm M/s Apurva Enterprises agreed that the two partners Narcinva Purxotoma Quenim and Smt. Crisnabai Vaman Quenim, shall disassociate from the partnership firm and Mandovi Hotels Private Limited (the assessee) shall continue the business. Subsequently, the Dissolution Deed was executed between the partners on 4th September, 1990 whereby the partners decided to

dissolve the partnership firm as from lst September, 1990. They also agreed that all the assets and liabilities of the partnership business shall be taken over by the partner Mandovi Hotels Private Limited and the business shall continue to be carried on by the said partner on and from 1st September, 1990. Inter alia, the parties declared and agreed in the Dissolution Deed thus:-

> "All the liabilities as on the said date have also been taken over by the continuing partner. The Partnership business shall be continued solely by the Third Part from the 1st day of September, 1990, to the entire exclusion of the retiring partners.
>
> In consideration of the above, the party of the Third Part hereby agree and undertake to pay the retiring Partners as Provided hereunder.
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> The continuing partner shall pay to the retiring Partners annually a sum equivalent to 30% of the net profits of the business, subject to a minimum amount of Rs.60,000/- for a period of seven years, commencing from 1st day of September, 1990."

3. It was thus agreed upon between the partners that all the assets of the partnership business as on 31st August, 1990 would be taken over by the continuing partner, i.e. the assessee and that

the partnership business would be continued solely by the assessee from 1st September, 1990. The assessee agreed and undertook to pay to the retiring partners annually a sum equivalent to 30% of the net profits of the business subject to a minimum amount of Rs.60,000/- for a period of seven years commencing from 1st September, 1990. Can it be said that the amount so paid by the assessee in the relevant year calculated at the rate of 30% of the net profits of the business to the erstwhile partners is capital in nature? The agreement that the assessee shall pay to the retiring partners annually a sum equivalent to 30% of the net profits of the business subject to a minimum amount of Rs.60,000/- leads us to hold that it is related to the annual profits which flow from the business activities of the assessee. Though much emphasis was placed by the learned counsel for the revenue that by the aforenoticed agreement a minimum amount of Rs.60,000/- was agreed to be paid by the assessee for a period of seven years which showed that the payment has relation to the actual value of the assets and was a consideration to the erstwhile partners for their disassociation from the firm. In our view the fact that the Dissolution Deed provides for a sum equivalent to

30% of the net profits of the business though subject to minimum amount of Rs.60,000/- , shows that the said sum of 30% net profits every year for seven years is not related to or tied up in any way to any fixed sum agreed to between the parties, as part of the consideration to the retiring partners for disassociating from the partnership firm. The Dissolution Deed does not refer to any capital sum anywhere. The minimum amount of Rs.60,000/- referred to in the Dissolution Deed cannot be construed to be a capital sum since the agreement by the assessee was to pay to the retiring partners a sum equivalent to 30% of the net profits of the business subject, ofcourse, to the minimum amount of Rs.60,000/- . Thus the agreement between the parties which is reflected from the Dissolution Deed and the surrounding circumstances including the memorandum of understanding show that the payment made by the assessee to the continuing parties is related to the annual profits that flow from the activities of the assessee firm and it cannot be said to have relation to the capital value of the assets of the estate and also the payment so made is not related or tied up in any way to any fixed sum agreed between the parties as part of the consideration to the retiring partners for

disassociating from the firm. The expenditure thus, in the sum of Rs. 1,34,678/- cannot be construed to be an expenditure in capital nature.

4. Before the Income Tax Appellate Tribunal, the various judgments were cited by the assessee as well as by the revenue in support of their case. Inter alia, the assessee heavily relied upon the judgment of the Supreme Court in the case of ***Travancore Sugars And Chemicals Limited vs. Commissioner of Income-tax, Kerala***, 62 ITR 566. The assessee also relied upon the judgment of the Supreme Court in the case of ***Devidas Vithaldas And Company vs. Commissioner of Income-Tax, Bombay City 1***, 84 ITR 277 and ***Commissioner of Income-Tax, Bombay City 11 vs. Sitaldas Tirathdas***, 41 ITR 367. On the other hand, the revenue placed reliance on the judgment of the Supreme Court in the case of ***Commissioner of Income-Tax, Central, Bombay vs. Jalan Trading Co. Pvt. Limited***, 155 ITR 536.

5. Since the assessee has not put in appearance, we considered the aforesaid judgments with the assistance of the learned counsel for the revenue.

6. As has been said umpteen times that the question

whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure has to be decided on the facts of each case. The Court has to ascertain the true nature and the character of the transaction from the terms of the agreement and the surrounding circumstances. No single test is decisive. However, the broad tests laid down by the Courts from time to time though applied in the peculiar facts of that case may help in deciding and determining whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure.

7. The line of demarcation between capital expenditure and revenue expenditure is very thin. As has been highlighted by the Supreme Court in the case of ***Assam Bengal Cement Co. Ltd. vs. Commissioner of Income-tax, West Bengal***, (1955) 27 ITR 34. In the case of ***Travancore Sugars And Chemicals Limited vs. Commissioner of Income-tax, Kerala***, (supra), the Supreme Court again cautioned that it is often difficult, in any particular case, to decide and determine whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure. It is not easy to distinguish whether an agreement is

for the payment of price stipulated in instalments or for making annual payments in the nature of income. The court has to look not only into the documents but also at the surrounding circumstances so as to arrive at a decision as to what was the real nature of the transaction from the commercial point of view. No single test of universal application can be discovered for a solution of the question. The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little consequence. In the backdrop of these observations, the Supreme Court in the facts and circumstances that were obtaining in the case of ***Travancore Sugars And Chemicals Limited vs. Commissioner of Income-tax, Kerala*** , (supra), held thus:-

> "Examining the transaction from this point of view, it is clear in the present case that the consideration for the sale of the three undertakings in favour of the appellant was : (1) the cash consideration mentioned in the principal agreement, viz., clauses 3, 4(a) and 5(a), and (2) the consideration that Government shall be entitled to twenty per cent of the net profits earned by the appellant in every year subject to a

maximum of Rs. 40,000 per annum. With regard to the second part of the consideration there are three important points to be noticed. In the first place, the payment of commission of twenty per cent on the net profits by the appellant in favour of the Government is for an indefinite period and has no limitation of time attached to it. In the second place, the payment of the commission is related to the annual profits which flow from the trading activities of the appellant-company and the payment has no relation to the capital value of the assets. In the third place, the annual payment of 20 per cent commission every year is not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertakings. There is no reference to any capital sum in this part of the agreement. On the contrary, the very nature of the payments excludes the idea that any connection with the capital sum was intended by the parties. It is true that the purchaser may buy a running concern and fix a certain price and the price may be payable in a lump sum or may be payable by instalments. The mere fact that the capital sum is payable by instalments spread over a certain length of time will not convert the nature of that payment from the capital

> expenditure into a revenue expenditure, but the payment of instalments in such a case would always have some relationship to the actual price fixed for the sale of the particular undertaking. As we have already mentioned, there is no specific sum fixed in the present case as an additional amount of price payable in addition to the cash consideration and payable by instalments or by any particular method. In view of these facts we are of opinion that the payment of the annual sum of Rs. 42,480 in the present case is not in the nature of capital expenditure but is in the nature of revenue expenditure and the judgment of the High Court of Kerala on this point must be overruled".

8. In ***Devidas Vithaldas And Company vs. Commissioner of Income-tax, Bombay City 1***, (supra) the Supreme Court observed that in distinguishing between capital and revenue expenditure the courts applied in different cases, different tests. None-the-less, none of them by itself is conclusive and the determination one way or the other has to emerge on the facts and in the circumstances of each case. The Supreme Court then observed thus:-

"One of the tests so applied is whether the expenditure in question was for bringing into existence an asset or an advantage of `an enduring nature', and is made `once and for all', meaning thereby an expenditure made once and for all for procuring and enduring benefit. It may be payable not necessarily all at once but even by instalments as against a recurrent expenditure in the nature of operational expenses. (See Assam Bengal Cement Co. Ltd. v. Commissioner of Income-tax). The question in such cases would be, is the expenditure the assessee's working expenses laid out as part of the process of profit earning or a capital outlay necessary for the acquisition of a property or of rights of a permanent character, the possession of which is a condition of carrying on the trade. But the expressions, `enduring benefit', and `rights of a permanent nature', are only descriptive and not definitive and are relative in meaning, not synonymous with perpetual or everlasting. For instance, an expenditure incurred in common with other companies producing copper to bring down production so as to prevent a steep fall in the prices was construed to mean for one of them to be out of production for 12 months only and not for good. On such construction, it was held

that to call such an expenditure a capital expenditure would be contradiction in terms, for, it was not and was not intended to be one for acquiring a right of an enduring benefit or as an accretion to the capital or income earning structure of the business. In Commissioner of Income-tax v. Coal Shipments (P.) Ltd. an agreement was arrived at between two companies exporting coal to Burma. The assessee-company agreed thereunder to pay, in consideration of the other company forbearing from exporting and procuring coal for its export by the assessee-company, five annas per ton (subsequently raised to Rs. 1-5-0 per ton). The amounts so paid to the other company were taxed in the hands of that company. The respondent-company claimed them as admissible business expenditure for the assessment year in question. The revenue, on the other hand, claimed that the payments were for acquiring monopoly and were, therefore, not allowable as revenue expenditure. This court upheld the assessee's contention that the expenditures were not for acquiring the monopoly, but were made to make the business more facile and profitable, that they were made as a temporary measure and not for deriving an advantage of an enduring character. Observing

that the agreement between the two companies was not for any fixed term and could be terminated at any time at the volition of any of the parties, it was held that, although an enduring benefit need not be of an everlasting character, it should not at the same time be transitory or ephemeral, so that it can be terminated at any time at the volition of either of the parties. Payments to ward off competition would constitute capital expenditure, provided the object is to derive an advantage by eliminating the competition over some length of time but such a result would not follow if there is no certainty of duration for such an advantage and the same could be put an end to at any time. Thus, what the extent of durability or permanence should be depends on the facts of each case.

Payments made by a lessee of a limestone quarry to the Government, who were the lessors, in consideration of a covenant which eliminated competition in the lessee's field of operations for twenty years, which was the lease period, were held to be capital expenditure for acquiring an enduring benefit to the lessee. On the other hand, registration of trade-marks under the Trade Marks Act, 1940, valid for a period of seven

years only, on the expiry of which it had to be renewed by paying fresh fees, was held not to bring any enduring benefit, and, therefore, the fees paid for registration were not capital but revenue expenditure. Registration is only a mode of ensuring the exclusive right in a trade-mark, and not the acquisition of the trade-mark itself, which would be an acquisition of a capital asset. Such a distinction was made in a case where expenditure was for the renewal of a licence, which was held to be a payment made as purchase price of a monopoly for the duration of the licence, which was only for twelve months. The thing that was paid for, it was said, was of a permanent quality, that is, the monopoly, although its permanence being conditioned by the renewal of the terms under which the licence was granted was short-lived. Such an expenditure was treated as of that class to which a premium on the grant of a lease belongs, which, admittedly, is not deductible. (See Henriksen v. Grafton Hotel Ltd.). In Strick v. Regent Oil Co. Ltd., Lord Reid, however, limited the decision in Henriksen's case, to its own special facts and expressed his disagreement with it if it was to be held to have laid down any general proposition. The expression `enduring

advantage' is, thus, a relative term, not enduring in the sense of its being permanent, but is sufficiently durable depending upon the nature of the terms upon which it can be acquired. So also the expression `once and for all', which does not mean payment at one time of the whole amount, but includes payment of a lump sum as distinct from recurrent, distributed in periodic instalments.

The other test sometimes applied is payment when it is referable to fixed capital or capital assets as against payment referable to circulating capital or stock-in-trade. But, this test also is not capable of being treated as of uniform application. Price paid for the acquisition of a capital asset may take sometimes the form of payments of a revenue character. The simplest example is interest paid on the unpaid purchase price of capital asset. Though in relation to and referable to acquisition of a capital asset, it is nonetheless a revenue disbursement. On the other hand, in Assam Bengal Cement Co. v. Commissioner of Income-tax, where the payment in question was for eliminating competition, the test of the expenditure having been incurred for and referable to a capital asset was applied.

> Acquisition of the goodwill of the business is, without doubt, acquisition of a capital asset, and, therefore, its purchase price would be capital expenditure. It would not make any difference whether it is paid in a lump sum at one time or in instalments distributed over a definite period. (See In re Ramjidas Jaini & Co. and Kuppuswami v. Commissioner of Income-tax). Where, however, the transaction is not one for acquisition of the goodwill, but for the right to use it, the expenditure would be revenue expenditure".

9. In ***Commissioner of Income-Tax, Central, Bombay vs. Jalan Trading Co. Pvt. Limited***, (supra), the Supreme Court referred to its previous decision in ***Travancore Sugars And Chemicals Limited vs. Commissioner of Income-tax, Kerala***, (supra), and distinguished the same by observing thus:-

> "The facts of Travancore Sugars & Chemicals' case [1966] 62 ITR 566 (SC) were peculiar. The assessee in that case purchased Travancore Sugars Ltd., a Government distillery at Nagercoil, and the business assets of a Government Tincture Factory at Trivandrum under an agreement dated June 18, 1937, entered into between the Government of Travancore and the

promoters of the assessee company. Under the agreement, cash consideration of Rs. 3,25,000 was to be paid for buying the assets of Travancore Sugars Ltd. In regard to the distillery, the sale price had to be arrived at on the basis of joint valuation by the engineers to be appointed by the parties. As regards the Tincture Factory, the book valuation was to be adopted for fixing the consideration. The existing distillery licence was agreed to stand recognised in the hands of the assessee for period of five years after its termination. Government also undertook to purchase pharmaceutical products manufactured by the assessee at the Tincture Factory. Government reserved the right to nominate a director on the board of directors of the assessee company without voting powers. The agreement further stipulated payment to the Government of 20% of the net profits earned by the company every year subject to a limit of Rs.40,000 per annum and certain other payments were also undertaken. The 20% stipulation was reduced to 10% by a subsequent agreement. The question that fell for consideration was whether payment of Rs.42,480 by the assessee company to the Travancore Government in terms of the agreement referred to above as modified, was

allowable expenditure under s. 10 of the Act in the year under consideration. This court stated (p.570 of **62 ITR**):

> ' It is often difficult, in any particular case, to decide and determine whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure. It is not easy to distinguish whether an agreement is for the payment of price stipulated in instalments or for making annual payments in the nature of income. The court has to look not only into the documents but also at the surrounding circumstances so as to arrive at a decision as to what was the real nature of the transaction from the commercial point of view. No single test of universal application can be discovered for a solution of the question. The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little consequence. The court has to ascertain the true nature and character of the transaction from the covenants of

> the agreement tested in the light of surrounding circumstances'."

10. The Supreme Court also observed that insofar as the tests are concerned, the test laid down in ***Assam Bengal Cement Co. Ltd. vs. Commissioner of Income-tax, West Bengal*** (supra) and ***Travancore Sugars And Chemicals Limited vs. Commissioner of Income-tax, Kerala*** , (supra) were not different.

11. It is interesting to note that in ***Commissioner of Income-Tax, Central, Bombay vs. Jalan Trading Co. Pvt. Limited*** , (supra), the Supreme Court also referred to its later decision after remand in ***Travancore Sugars And Chemicals Limited vs. Commissioner of Income-tax, Kerala*** , 88 ITR 1 and referred to para 10 of the report wherein the following observations were made:-

> "In considering the nature of the expenditure incurred in the discharge of an obligation under a contract or a statute or a decree of some similar binding covenant, one must avoid being caught in the maze of judicial decisions rendered on different facts and which always present distinguishing features for a comparison with the facts and circumstances of the case in hand. Nor

> would it be conducive for clarity or for reaching a logical result if we were to concentrate on the facts of the decided cases with a view to match the colour of that case with that of the case which requires determination. The surer way of arriving at a just conclusion would be to first ascertain by, reference to the document under which the obligation for incurring the expenditure is created and thereafter to apply the principle embalmed in the decisions of those facts. Judicial statements on the facts of a particular case can never assist courts in the construction of an agreement or a statute which was not considered in those judgments or to ascertain what the intention of the legislature was. What we must look at is the contract or the statute or the decree, in relation to its terms, the obligation imposed and the purpose for which the transaction was entered into."

12. The Supreme Court in ***Jalan's*** case (supra) highlighted that judicial decisions on facts of a particular case can never assist courts in construction of an agreement. The contract must be looked into in relation to its terms and associated aspects like the object and obligations. The Supreme Court referring to the facts obtaining in ***Jalan's*** case (supra) observed thus:-

> "M/s. Jalan Trading Co., a partnership firm, had initially been appointed as the sole selling agent. On October 16, 1952, the assessee company came to be incorporated and soon after incorporation by agreement, the rights of the firm were assigned to the assessee company. Neither the ITO nor the two appellate authorities and nor even the High Court went into the question as to whether the assessee was in fact separate from, and independent of, the partnership firm. It is true that the tenability of the claim of deductibility as a business expenditure of the amount was examined by taking it for granted that the payment had been made by the assessee to the firm. But the exact position not having been investigated, no finding has been recorded at any stage. The fact that the partnership and the assessee company bear the same name and soon after incorporation, the agreement assigning the firm's rights in favour of the company had been entered, had obviously led the ITO to doubt the bona fides."

13. ***Jalan's*** case (supra), upon which strong reliance is placed by the learned counsel for the revenue, cannot be applied to the facts of this case. In that case neither the assessing officer nor

the appellate authority nor the Appeal Tribunal nor the High Court went into the question whether the assessee was in fact a separate firm, and independent of, the partnership firm. The exact position was not investigated, nor any finding recorded. Even otherwise, as has been repeatedly held by the Supreme Court whether an expenditure is allowable as revenue or capital expenditure, has to be decided on the facts of each case. In the facts and circumstances of the present case, the agreement between the parties as is discerned from the Dissolution Deed, it can safely be said that payment of 30% of net profits payable by the assessee company to the retiring partners for a period of seven years subject to the minimum payment of Rs.60,000/- was related to annual profits that flow from the business activities of the assessee company and the said payment cannot be related to the capital value of the assets. The Dissolution Deed does not specify any capital sum payable to the retiring partners. The payment of 30% of the annual profits, subject to minimum of Rs.60,000/- every year for seven years, cannot be held to be the fixed price for purchase of the capital assets. All in all, the expenditure in the sum of Rs. 1,34,678/- by the assessee in the relevant year cannot

be said to have been wrongly held by the Appellate Tribunal as revenue expenditure.

14. We, accordingly, answer the question by holding that the amount of Rs.l,34,678/- paid by the assessee to the retiring partners is in the nature of revenue expenditure.

15. The Appeal is dismissed. Since the assessee has not chosen to appear, we direct the appellant to bear its own costs.

R. M. LODHA, J.

N. A. BRITTO, J.

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